



# The Week in Muniland

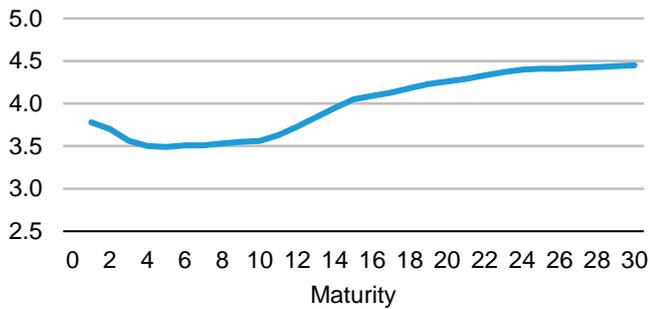
October 9, 2023

## Reason Will Prevail

- + A stronger-than-expected US jobs report rattled the bond markets on Friday. For the week, two-, 10- and 30-year AAA municipal yields rose 4, 11 and 11 basis points (bps), respectively. In comparison, two-, 10- and 30-year US Treasury (UST) yields increased 3, 22 and 26 bps, respectively. For the week, the Bloomberg Municipal Bond Index (Index) returned -0.64%.
  - **Why it matters:** The Fed has bludgeoned the market into its way of thinking, which is why rates are going to be higher for longer. As such, the market remains extremely data dependent, as does the Fed. The UST market continues the search for the marginal buyer that will put a ceiling on long rates. Until that occurs, yields will likely drift higher in the near term. On the bright side, the long end of the curve is doing the Fed's job by continuing to tighten financial conditions. Higher yields, combined with a weaker stock market, may give the Fed reason to pause come November. While this bout of volatility has been unnerving to some investors, the by-product of that volatility is a historically strong return opportunity going forward. The Index yield to worst is now 4.43%, which is the highest it's been since December 2008 (*Display 2*). On a taxable equivalent basis, this yield is a stunning 7.48%! The asymmetry of the Index's total return going forward is substantial. If the 10-year UST yield increases 100 bps over the next 12 months, the Index total return would likely be flat to slightly positive. However, if rates fall 100 bps, the Index return would be approximately 8.4%. Bonds will heal themselves over time...It's just math. The pieces are in place for the market to rally; investors now just need to show up.
- + The US economy added 336,000 jobs in September, far exceeding forecasts, which were generally a bit below 200,000.
  - **Why it matters:** In addition, the past two months were upwardly revised by 120,000 jobs, making this an exceptionally strong report from a hiring perspective. Wages were a bit softer than expected at 0.2% month over month and 4.2% year over year, but even taking that into account, it is clear that the labor market remains strong. From a policy perspective, data like this keep the idea of an additional Fed hike live. While we continue to believe that the Fed will not hike again, it is becoming a very close call. Our forecast is based on an expectation that growth will slow; some parts of the data flow reflect that, but the labor market does not. We expect that the recent tightening of financial conditions will weigh on growth forecasts but eventually the Fed will need to see tangible evidence of slower growth in order to be confident in the inflation outlook. On Friday, the market had a 32% probability of the Fed hiking in November, up from 23% a day earlier. If the market gets to 50% or better the Fed may just give the market what it expects.
- + The bond-rating agencies recently upgraded or moved to positive outlook the bond ratings for various municipal bond issuers.
  - **Why it matters:** While a slowing economy has naturally resulted in a slowdown in state revenue growth, states continue to be in extraordinarily good fiscal shape. The New York Metropolitan Transportation Authority (MTA) saw its rating upgraded to A- from BBB+ by S&P, which cited increasing ridership (which is now at about 70% of 2019 levels on the subway) and additional aid from state lawmakers. S&P also has the MTA's rating on positive outlook, so we could see more upgrades in the coming years. Pennsylvania's outlook was raised to positive from stable by both Moody's and S&P in September, with these agencies highlighting the state's positive operating results for several years running; those results have bolstered reserves. And while no rating action was taken for Connecticut recently, it is worth noting that the state made a surplus deposit to its pension plans for the fourth year in a row, bringing its total surplus pension contributions to \$7.7 billion over that time. Another example of fiscal strength is Texas, which revised its revenue estimate higher for the 2024–2025 biennium and projects that revenue will be 25% higher than what was available in the 2022–2023 biennium. Texas already has about \$24 billion in its rainy day fund, and it appears likely they will add to this over the next two years.

## Displays of the Week: October 9, 2023

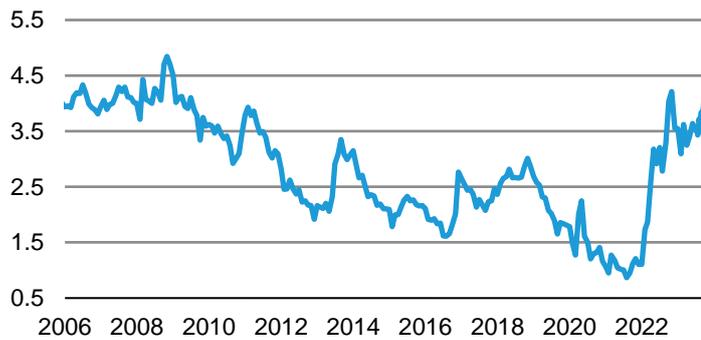
### Display 1: AAA-Rated Municipal Yields (Percent)



Through October 6, 2023  
Source: Municipal Market Data and AB

The municipal yield curve is inverted. A barbell maturity structure remains most advantageous.

### Display 2: Historical Yield to Worst (Percent)



Through October 6, 2023, for Bloomberg Municipal Bond Index  
Source: Bloomberg and AB

Muni yields are among the highest they have been since 2008.

### Display 3: Municipal and Treasury After-Tax Spreads (Basis Points)

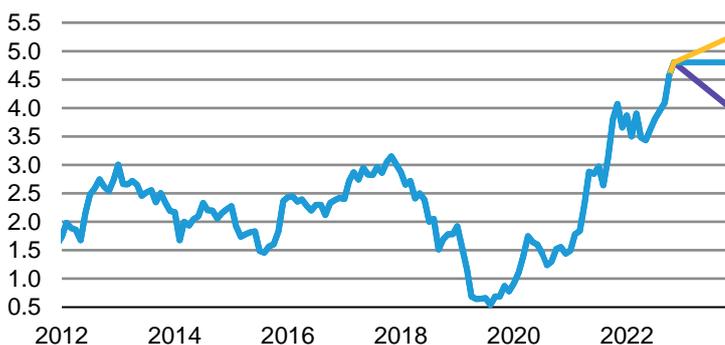
	Sept 28, 2022	July 31, 2023	Oct 6, 2023	Five-Year Average
Two-Year	62	9	68	16
Five-Year	76	16	64	22
10-Year	110	25	73	49
15-Year	132	72	110	73
20-Year	133	101	120	79
30-Year	168	114	151	91

As of October 6, 2023  
Source: Bloomberg, Municipal Market Data and AB

Munis are becoming too cheap relative to US Treasuries.

### Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-year US Treasury Yield (Percent)



10-Year Treasury, 5.25% → 3.15%

10-Year Treasury, 4.80% → 4.70%

10-Year Treasury, 4.00% → 7.45%

#### Past performance and historical analysis do not guarantee future results.

Display reflects expected returns of the Bloomberg Municipal Index under three scenarios: 10-year US Treasury yields rise to 5.25%, remain the same or decline to 4.00% over the next 12 months.

As of October 6, 2023  
Source: Bloomberg and AB

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